

Report  
of the  
Examination of  
Merrimac Mutual Insurance Company  
Plain, Wisconsin  
As of December 31, 2004

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# State of Wisconsin / OFFICE OF THE COMMISSIONER OF INSURANCE

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**Jorge Gomez, Commissioner**

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May 13, 2005

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Honorable Jorge Gomez  
Commissioner of Insurance  
State of Wisconsin  
125 South Webster Street  
Madison, Wisconsin 53702

Commissioner:

In accordance with your instructions, an examination has been performed as of  
December 31, 2004, of the affairs and financial condition of:

MERRIMAC MUTUAL INSURANCE COMPANY  
Plain, Wisconsin

and the following report thereon is respectfully submitted:

## I. INTRODUCTION

The previous examination of Merrimac Mutual Insurance Company (the company) was made in 1999 as of December 31, 1998. The current examination covered the intervening time period ending December 31, 2004, and included a review of such subsequent transactions deemed essential to complete this examination.

The "Summary of Examination Results" contains elaboration on all areas of the company's operations. Special attention was given to the action taken by the company to satisfy the recommendations and comments made in the previous examination report.

The company was originally organized as a town mutual insurance company in November 1873, under the provisions of the then existing Wisconsin Statutes. The original name of the company was the Merrimac Mutual Farmer's Fire Insurance Company. Subsequent amendments to the company's articles and bylaws changed the company's name to that presently used.

During the period under examination, there were no amendments to the articles of incorporation and no amendments to the bylaws.

The company is currently licensed to write property, including windstorm and hail, and nonproperty insurance. The company is currently licensed to write business in the following counties: Columbia, Iowa, Dane, and Sauk.

A review was made of the policy and application forms currently used by the company. The company issues an approved policy with or without endorsements for terms of three years with premiums payable on the advance premium basis. Premiums are paid in monthly, quarterly, semiannual, and annual installments with installment fees of 8% of the installment payment on monthly, 6% of the installment payment on quarterly, and 2% of the installment payment on semiannual, payable with each installment. Installment fees charged policyholders are retained by the company. The company does not charge policy fees.

Business of the company is acquired through five agents, one of which is a director of the company. Agents are presently compensated for their services as follows:

<b>Type of Policy</b>	<b>Compensation</b>
All Lines	10%

The company allows directors to adjust claims but does hire professional adjusters when it is felt necessary. Directors have authority to adjust losses up to \$2,500. Losses in excess of this amount are required to be adjusted by two directors. Adjusters receive \$25 for each loss adjusted plus mileage reimbursement paid at 40.5 cents per mile.

Policyholders may participate in the management and control of the company by attending and voting at all annual or special meetings of the members. No member may vote by proxy. The annual meeting of the company for the election of directors and special meetings of the company are held in accordance with its articles of incorporation.

#### **Board of Directors**

The board of directors consists of six members divided into three classes. One class is elected at each annual meeting for a term of three years. Vacancies on the board may be filled

by the directors for the interim to the next annual meeting when a director shall be chosen for the unexpired term.

The current board of directors consists of the following policyholders of the company:

<b>Name</b>	<b>Principal Occupation</b>	<b>Residence</b>	<b>Expiry</b>
Alan Albers*	Farmer	Plain, Wisconsin	2006
William Been	Farmer/Teacher	Spring Green, Wisconsin	2007
Timothy Colby	Farmer	North Freedom, Wisconsin	2005
Carl Graf	Retired Farmer	Prairie du Sac, Wisconsin	2005
Craig Sandmire	Sales	North Freedom, Wisconsin	2006
Verlyn Zins	Retired Farmer	Sauk City, Wisconsin	2007

\* Directors who are also agents are identified with an asterisk.

Members of the board currently receive \$75 for a full day and \$50 for a half day meeting attended and mileage reimbursement paid at 40.5 cents a mile.

#### **Officers**

Officers are elected by the board of directors from among its members and hold office for one year or until their successors are duly elected and qualified. Officers serving at the present time are as follows:

<b>Name</b>	<b>Office</b>	<b>2004 Total Compensation</b>
Verlyn Zins	President	\$ 1,525
Carl Graf	Vice-President	504
Alan Albers	Secretary	63,266
Timothy Colby	Treasurer	7,275

Amounts reported above include officer salaries approved by the board of directors along with agent commissions and director fees.

## Committees of the Board

The company's bylaws allow for the formation of certain committees by the board of directors. The committees at the time of the examination are listed below:

### **Claim Committee**

Alan Albers, Chair  
William Been  
Timothy Colby  
Carl Graf  
Craig Sandmire  
Verlyn Zins

### **Auditing Committee**

Carl Graf, Chair  
Craig Sandmire  
Verlyn Zims

## Growth of Company

The growth of the company since the previous examination as compiled from its filed annual statements was as follows:

<b>Year</b>	<b>Net Premiums Earned</b>	<b>Policies In Force</b>	<b>Net Income</b>	<b>Admitted Assets</b>	<b>Policyholders' Surplus</b>
2004	\$353,909	1,427	\$13,846	\$3,063,628	\$2,714,048
2003	329,674	1,349	168,701	2,947,622	2,619,790
2002	305,841	1,241	125,760	2,672,581	2,341,019
2001	315,878	1,166	100,235	2,660,631	2,345,194
2000	295,295	1,143	61,426	2,612,594	2,314,593
1999	297,701	1,131	41,513	2,544,755	2,280,755
1998	308,393	1,158	28,038	2,472,027	2,161,426

The ratios of gross and net premiums written to surplus as regards policyholders since the previous examination were as follows:

<b>Year</b>	<b>Gross Premiums Written</b>	<b>Net Premiums Written</b>	<b>Ending Surplus</b>	<b>Writings Net</b>	<b>Ratios Gross</b>
2004	\$689,391	\$376,509	\$2,714,048	14%	25%
2003	642,817	351,674	2,619,790	13	25
2002	579,447	322,941	2,341,019	14	25
2001	559,203	320,978	2,345,194	14	24
2000	534,232	305,767	2,314,593	13	23
1999	515,194	293,416	2,280,755	13	23
1998	521,367	324,706	2,161,426	15	24

For the same period, the company's operating ratios were as follows:

<b>Year</b>	<b>Net Losses and LAE Incurred</b>	<b>Other Underwriting Expenses Incurred</b>	<b>Net Premiums Earned</b>	<b>Loss Ratio</b>	<b>Expense Ratio</b>	<b>Com- posite Ratio</b>
2004	\$252,918	\$164,976	\$353,909	71%	44%	115%
2003	106,172	136,869	329,674	32	39	71
2002	130,888	139,934	305,841	43	43	86
2001	221,777	131,938	315,878	70	41	111
2000	214,593	131,433	295,295	73	43	116
1999	231,070	123,118	297,701	78	42	120
1998	282,452	132,474	308,393	92	41	132

The company has generated net income each year, increased admitted assets 23.9%, and increased surplus 25.6% since the prior exam. The company has had steady growth in both the gross and net premiums written and the number of policies in force. With the exception of 2004, a year in which the company had two significant losses, the company has kept its underwriting ratio at or under the average for the Wisconsin town mutual industry as a whole.

## II. REINSURANCE

The examiners' review of the company's reinsurance portfolio revealed there is currently one ceding treaty. The treaty contained a proper insolvency clause and complied with s. Ins 13.09 (3), Wis. Adm. Code, concerning maximum wind loss. Company retentions of risk complied with s. Ins 13.06, Wis. Adm. Code.

Reinsurer:	Wisconsin Reinsurance Corporation
Effective date:	January 1, 2004
Termination provisions:	Either party may terminate the contract on any January 1 by giving 90 days' advance notice to the other party.

The coverages provided under this treaty are summarized as follows:

- |                      |  |
|----------------------|--|
| Type of contract:    | Class A Excess of Loss   |
| Lines reinsured:     | Casualty and Liability (nonproperty)   |
| Company's retention: | \$750 in respect to each and every loss occurrence.  |
| Coverage:            | 100% of any loss, including loss adjustment expense, in excess of company's retention in respect to each and every loss occurrence, limited to \$1,000,000 per occurrence and in any combination of bodily injury and property liability. Medical payments of \$5,000 per person, \$25,000 per accident and a \$1,000 milk contamination deductible. |
| Reinsurance premium: | 75% of the premium written   |
- |                      |  |
|----------------------|--|
| Type of contract:    | Class B First Surplus  |
| Lines reinsured:     | Property   |
| Company's retention: | Retention is on a per-risk pro rata basis  |
| Coverage:            | When net retention is \$300,000 or more in respect to a risk, the reinsurer shall accept up to \$800,000 per risk on a pro rata basis. When the net retention is \$300,000 or less in respect to a risk, the reinsurer shall accept up to 50% of such risk. The reinsurer shall be liable for the pro rata portion of each and every loss, including loss adjustment expense, corresponding to the amount of risk ceded. |
| Reinsurance premium: | 100% of the unearned premium applicable to business covered by this exhibit as of January 1, 2004, and a pro rata portion of all premiums, fees, and assessments charged corresponding to the amount of each risk ceded.   |
| Ceding commission:   | 15% of premium paid to reinsurer.  |



- Additional commission: Commission of 15% of net profit, if any. Net profit is defined as premiums earned minus ceding commission minus 10% of premiums for expenses incurred by reinsurer minus loss and loss adjusting expenses minus any net loss carry-forward per the reinsurers 12/31/03 calculation.
3. Type of contract: Class C-1 Excess of Loss – First Layer
- Lines reinsured: Property business
- Company's retention: After an annual aggregate deductible of \$25,000, \$30,000 in respect to each and every loss occurrence.
- Coverage: 100% of any loss, including loss adjustment expense, in excess of company's retention in respect to each and every loss occurrence, limited to \$70,000 per occurrence.
- Reinsurance premium: Net premium written (NPW) multiplied by the sum of prior four years' losses (plus paid outstanding) divided by the total of NPW for the corresponding five years multiplied by 100/80. Minimum of 6.5%, maximum of 20% of the current net written premiums. Current year rate is 6.5%, a deposit premium of \$25,800 with a minimum premium of \$21,000.
4. Type of contract: Class C-2 Excess of Loss – Second Layer
- Lines reinsured: Property business
- Company's retention: \$100,000 in respect to each and every risk resulting from one loss occurrence.
- Coverage: 100% of any loss, excluding loss adjustment expense, in excess of \$100,000 in respect to each and every risk resulting from one loss occurrence with the reinsurers limit of liability being \$200,000 in respect to each and every loss occurrence.
- Reinsurance premium: 5% of net premiums written in respect to the business covered hereunder, subject to a deposit premium of \$20,100 with a minimum premium of \$16,000.
5. Type of contract: Class D/E Stop Loss – First Layer
- Lines reinsured: Property and Nonproperty business
- Company's retention: 75% of net premiums written, minimum net retention of \$261,000.
- Coverage: 100% of aggregate losses, including loss adjustment expenses, over company's retention in any annual period.
- Reinsurance premium: Calculated by taking the sum of the last eight years' losses incurred by the reinsurer divided the total net premiums written for the same period multiplied by 100/80. Minimum of 6.5%, maximum of 25% of the current net written premiums. Current year rate is 6.5%, a deposit premium of \$35,100 with a minimum premium of \$23,000.

### **III. FINANCIAL DATA**

The following financial statements reflect the financial condition of the company as reported to the Commissioner of Insurance in the December 31, 2004, annual statement.

Adjustments made as a result of the examination are noted at the end of this section in the area captioned "Reconciliation of Policyholders' Surplus."

**Merrimac Mutual Insurance Company**  
**Statement of Assets and Liabilities**  
**As of December 31, 2004**

<b>Assets</b>	<b>Ledger</b>	<b>Nonledger</b>	<b>Not Admitted</b>	<b>Net Admitted</b>
Cash in company's office	\$ 200	\$ 0	\$ 0	\$ 200
Cash deposited in checking account	55,641			55,641
Cash deposited at interest	280,419			280,419
Bonds	1,640,330			1,640,330
Stocks and mutual fund investments	930,502			930,502
Premiums, agents' balances and installments:				
In course of collection	21,010		193	20,817
Deferred and not yet due	64,366			64,366
Investment income accrued		20,832		20,832
Reinsurance recoverable on paid losses and lae	47,984			47,984
Fire dues recoverable	11			11
Commissions Receivable	2,526			2,526
Furniture and fixtures	<u>969</u>	<u>          </u>	<u>969</u>	<u>0</u>
<b>Totals</b>	<b><u>\$3,043,958</u></b>	<b><u>\$20,832</u></b>	<b><u>\$1,162</u></b>	<b><u>\$3,063,628</u></b>

**Liabilities and Surplus**

Net unpaid losses	\$ 15,000
Unpaid loss adjustment expenses	600
Commissions payable	11,220
Unearned premiums	279,600
Reinsurance payable	22,218
Amounts withheld for the account of others	1,684
Other liabilities:	
Expense related:	
Accounts payable	169
Nonexpense related:	
Premiums received in advance	<u>19,089</u>
<b>Total Liabilities</b>	<b>349,580</b>
<b>Policyholders' surplus</b>	<b><u>2,714,048</u></b>
<b>Total Liabilities and Surplus</b>	<b><u>\$3,063,628</u></b>

**Merrimac Mutual Insurance Company**  
**Statement of Operations**  
**For the Year 2004**

Net premiums and assessments earned		\$353,909
Deduct:		
Net losses incurred	\$217,588	
Net loss adjustment expenses incurred	35,330	
Other underwriting expenses incurred	<u>164,976</u>	
Total losses and expenses incurred		<u>417,894</u>
Net underwriting gain (loss)		(63,985)
Net investment income:		
Net investment income earned	73,123	
Net realized capital gains	<u>(2,806)</u>	
Total investment gain (loss)		70,317
Other income (expense):		
Miscellaneous	<u>7,514</u>	
Total other income		<u>7,514</u>
Net Income (Loss)		<u>\$ 13,846</u>

**Merrimac Mutual Insurance Company**  
**Reconciliation and Analysis of Surplus as Regards Policyholders**  
**For the six-Year Period Ending December 31, 2004**

The following schedule is a reconciliation of surplus as regards policyholders during the period under examination as reported by the company in its filed annual statements:

	<b>2004</b>	<b>2003</b>	<b>2002</b>	<b>2001</b>	<b>2000</b>	<b>1999</b>
Surplus, beginning of year	\$2,619,790	\$2,341,019	\$2,345,194	\$2,314,593	\$2,280,755	\$2,161,426
Net income	13,846	168,701	125,760	100,235	61,426	41,513
Net unrealized capital gains or (losses)	81,312	86,180	(128,505)	(69,831)	(27,881)	76,842
Change in nonadmitted assets	(900)	1,226	(1,430)	197	293	974
Other gains and (losses) in surplus:	<u>          </u>	<u>22,664</u>	<u>          </u>	<u>          </u>	<u>          </u>	<u>          </u>
Surplus, end of year	<u>\$2,714,048</u>	<u>\$2,619,790</u>	<u>\$2,341,019</u>	<u>\$2,345,194</u>	<u>\$2,314,593</u>	<u>\$2,280,755</u>

**Reconciliation of Policyholders' Surplus**

The examination resulted in no adjustments to policyholders' surplus. The amount reported by the company as of December 31, 2004, is accepted.

#### IV. SUMMARY OF EXAMINATION RESULTS

##### Compliance with Prior Examination Report Recommendations

Comments and recommendations contained in the last examination report and the action taken on them by the company are as follows:

1. Corporate Records—It is suggested that the Board of Directors review the compensation of the officers and consider a method of compensation that does not directly associate the pay of the officers with premium or insurance in force.

Action—Compliance

2. Disaster Recovery Plan—It is recommended that the company develop a disaster recovery plan.

Action—Partial compliance, see comments in the summary of current examination results.

3. Premiums and Agents' Balances in Course of Collection—It is again recommended that the company follow the annual statement instructions in regard to nonadmittance of agents' balances or premiums receivable over 90 days' past due.

Action—Compliance

4. Net Unpaid Losses—It is recommended that the company adopt procedures for timely settlement of claims, in compliance with s. Ins 6.11 (3) (a) 2, Wis. Adm. Code.

Action—Compliance

## **Current Examination Results**

### **Corporate Records**

The minutes of the annual meetings of policyholders and meetings of the board of directors and committees thereof were reviewed for the period under examination and also for the subsequent period.

Biographical data relating to company officers and directors have been reported in accordance with the provisions of s. Ins 6.52, Wis. Adm. Code.

The company has executed formal written agreements with its agents. The contracts include language indicating the agent will represent the company's interests "in good faith."

### **Conflict of Interest**

In accordance with a directive of the Commissioner of Insurance, each company is required to establish a procedure for the disclosure to its board of directors of any material interest or affiliation on the part of its officers, directors, or key employees which conflicts or is likely to conflict with the official duties of such person. A part of this procedure is the annual completion of a conflict of interest questionnaire by the appropriate persons. The company has adopted such a procedure for disclosing potential conflicts of interest. Conflict of interest questionnaires were reviewed for the period under examination with no apparent conflicts being noted.

### **Fidelity Bond and Other Insurance**

The company is afforded coverage under the terms of the following bonds or contracts and has complied with s. Ins 13.05 (6), Wis. Adm. Code, which sets forth the minimum requirements for fidelity bond coverage:

<b>Type of Coverage</b>	<b>Coverage Limits</b>
Fidelity Bond	\$ 250,000
Worker's Compensation:	
Employee injury	Statutory
Employee liability:	
Each accident	100,000
Each employee	100,000
Policy limit	500,000
Agent Errors & Omissions:	1,000,000
Directors and Officers:	
Professional Liability (PL)	2,000,000
Directors and Officers (DO)	2,000,000
Maximum Aggregate	2,000,000
Deductible for both PL and DO	5,000
Commercial Liability	
General Aggregate Limit	1,000,000
Products Aggregate Limit	1,000,000
Personal Injury Limit	1,000,000
Each Occurrence Limit	1,000,000
Damage to Premises	100,000
Medical Limit each person	5,000

### **Underwriting**

The company has a written underwriting guide. The guide covers all the lines of business that the company is presently writing. During the examination it was noted that the underwriting guide did not include current rates.

The company has a formal inspection procedure for both new and renewal business. During the examination it was noted that some policy files had no photographs taken during the inspection process. Therefore, it is suggested that the company periodically review and update its underwriting guide, including maintenance of current rates and require photographs of all insured risks in order to have better supporting documentation of the condition of the risks.

### **Claims Adjusting**

The company has an adjusting committee consisting of at least three directors as required by s. 612.13 (4), Wis. Stat. The function of this committee is to adjust or supervise the adjustment of losses.

### **Accounts and Records**

The examiners' review of the company's records indicated that the company is in compliance with s. Ins 13.05, Wis. Adm. Code, which sets forth the minimum standards for the



handling of cash and recording of cash transactions by town mutual insurance companies. The examiners noted the following:

1. A proper policy register is maintained
2. A proper cash receipts journal is maintained
3. A proper cash disbursements journal is maintained
4. A proper general journal is maintained
5. A proper general ledger is maintained

An extensive review was made of income and disbursement items. Cash receipts were traced from source records and the proper recording and eventual deposit thereof ascertained. Negotiated checks issued during the period under examination were reviewed, test checked for proper endorsement, and traced to cash records. The verification of assets and determination of liabilities were made as of December 31, 2004.

The company is audited annually by an outside public accounting firm.

During the examination it was determined that the company Treasurer is responsible for writing the disbursements, receiving and depositing receipts, and reconciling the bank statement. Pursuant to s. Ins 13.05 (4) (d), Wis. Adm. Code, whenever possible, bank reconciliations should be made or reviewed by an individual other than the individuals preparing and making bank deposits, recording income and disbursements, and individuals signing company checks. It is recommended that the company comply with s. Ins 13.05 (4) (d), Wis. Adm. Code, by transferring its bank reconciliation function to a person other than the Treasurer.

#### **EDP Environment**

Company personnel were interviewed with respect to the company's electronic data processing environment. Access to the computer is limited to people authorized to use the computer.

Company personnel back up the computers weekly and monthly and the backed-up data is kept both on and off-site.

A manual which describes how to use the company's software and outlines the steps to complete specific tasks assists in the continuity of operations for seldom-used applications, training, or when staff turnover occurs. The company has manuals documenting the use of its software.

## **Business Continuity Plan**

A business continuity plan identifies steps to be performed by a company in the event of business interruptions including, but not limited to, the inability to access its computer, the loss of information on its computer, the loss of a key employee, or the destruction of its office building. The company has developed a business continuity plan which appears to be adequate. However, it is suggested that the company expand its business continuity plan to address all types of disasters and develop an office procedure manual for the cross-training of employees.

## **Invested Assets**

Section 610.23, Wis. Stat., requires insurers to hold all investments and deposits of its funds in its own name except that:

- (1) Securities kept under a custodial agreement or trust arrangement with a bank or banking and trust company may be issued in the name of a nominee of the bank or banking and trust company; and
- (2) Any insurer may acquire and hold securities in bearer form.

For securities not held under a custodial agreement or trust arrangement with a bank or banking and trust company, s. Ins 13.05 (4), Wis. Adm. Code, requires that:

Non-negotiable evidences of company investments such as registered bonds, certificates of deposits, notes, etc., shall be maintained in a safe or vault with adequate safety controls or in a safety deposit box in a bank. Negotiable evidences of company investments shall be maintained in a safety deposit box in a bank. Access to a company safety deposit box containing negotiable securities shall require the presence and signature of at least 2 officers, directors or employees of the company.

The company is in compliance with these requirements.

## **Investment Rule Compliance**

The investment rule for town mutual insurers allows a company to invest in common stocks, common stock mutual funds, and other higher risk investments (referred to as "Type 2") provided that the town mutual has a sufficient amount of lower risk investments (referred to as "Type 1"). A town mutual may invest in Type 2 securities only if it already has sufficient Type 1 investments. Type 1 investments must equal or exceed the greater of items 1, 2, or 3.

1. Liabilities plus \$300,000	\$ 649,580
2. Liabilities plus 33% of gross premiums written	527,499
3. Liabilities plus 50% of net premiums written	488,255
4. Amount required (greater of 1, 2, or 3)	649,580
5. Amount of Type 1 investments as of 12/31/2004	<u>2,042,359</u>
6. Excess or (deficiency)	<u>\$1,392,779</u>

The company has sufficient Type 1 investments.

## **ASSETS**

### **Cash and Invested Cash**

**\$336,260**

The above asset is comprised of the following types of cash items:

Cash in company's office	\$ 200
Cash deposited in banks-checking accounts	55,641
Cash deposited in banks at interest	<u>280,419</u>
Total	<u>\$ 336,260</u>

Cash in company's office at year-end represents the company's petty cash fund. A physical count was made by the examiners during the course of the examination and the balance reconciled to year-end.

Cash deposited in banks subject to the company's check and withdrawal consists of one account maintained in a local bank. Verification of the checking account balance was made by obtaining confirmation directly from the depositor and reconciling the amounts shown thereon to company records.

Cash deposited in banks represents the aggregate of six deposits in five depositories. Deposits were verified by direct correspondence with the respective depositories and by an actual count and inspection of certificates and/or passbooks. Interest received during the year 2004 totaled \$8,716 and was verified to company cash records. Rates of interest earned on cash deposits ranged from 1.65% to 3.46%. Accrued interest on cash deposits totaled \$690 at year-end.

### **Book Value of Bonds**

**\$1,640,330**

The above asset consists of the aggregate book value of bonds held by the company as of December 31, 2004. Bonds owned by the company are located in a safety deposit box at a local bank or under a safekeeping agreement.

Bonds were physically inspected by the examiners. Bond purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in bonds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Interest received during 2004 on bonds amounted to \$79,035 and was traced to cash receipts records. Accrued interest of \$20,142 at December 31, 2004, was checked and allowed as a nonledger asset.

**Stocks and Mutual Fund Investments** **\$930,502**

The above asset consists of the aggregate market value of stocks and mutual funds held by the company as of December 31, 2004. Stocks owned by the company are located in a safety deposit box at a local bank or under a safekeeping agreement.

Stock certificates held in a safety deposit box were physically examined by the examiners. Stock and mutual fund purchases and sales for the period under examination were checked to brokers' invoices and advices. The company's investment in stocks and mutual funds was in conformance with Wisconsin Statutes and the rules of the Commissioner of Insurance as regards investments made by town mutual insurers.

Dividends received during 2004 on stocks and mutual funds amounted to \$22,805 and were traced to cash receipts records. There was no accrued dividend receivable balance at December 31, 2004.

**Premiums, Agents' Balances in Course of Collection** **\$20,817**

This asset represents the amounts due from agents or policyholders which are not in excess of 90 days past due at year-end. A review of individual agent's accounts verified the accuracy of this asset.

**Premiums Deferred and Not Yet Due** **\$64,366**

This asset represents modal premium installments (such as monthly, quarterly, etc.) that are not yet due. A review of a sample from the company's detailed list of deferred premiums verified the accuracy of this asset.

**Investment Income Accrued** **\$20,832**

Interest due and accrued on the various assets of the company at December 31, 2004, consists of the following:

Cash Deposited at Interest	\$ 690
Bonds	<u>20,142</u>
Total	<u>\$ 20,832</u>

**Reinsurance Recoverable on Paid Losses and LAE** **\$47,984**

The above asset represents recoveries due to the company from reinsurance on losses and loss adjusting expenses which were paid on or prior to December 31, 2004. A review of year-end accountings with the reinsurer verified the above asset.

**Fire Dues Recoverable** **\$11**

This asset represents the amount overpaid to the State of Wisconsin for 2004 fire dues. The examiners reviewed the company's fire department dues calculation and found this asset to be correctly calculated. The actual amount paid was verified to the cash disbursement records.

**Commission Receivable** **\$2,526**

The above asset represents the amount of commissions that the company expected to receive as of December 31, 2004, under its contract with its reinsurer. A review of the terms of the reinsurance agreement and year-end accountings with the reinsurer verified the above asset.

**Furniture and Fixtures** **\$0**

This asset consists of \$969 of office equipment owned by the company at December 31, 2004. In accordance with annual statement requirements, this amount has been reported as nonadmitted asset, thus the balance shown above is \$0.

## LIABILITIES AND SURPLUS

### Net Unpaid Losses

**\$15,000**

This liability represents losses incurred on or prior to December 31, 2004, that remained unpaid as of that date. The examiners reviewed the reasonableness of this liability by totaling actual loss payments made subsequent to December 31, 2004, with incurred dates in 2004 and prior years. There were reported and unpaid losses related to 2004 and prior as of the date of the examiners' review. The examiners' development of unpaid losses is compared with the amount estimated by the company in the following schedule.

	<b>Company Estimate</b>	<b>Examiners' Development</b>	<b>Difference</b>
Incurred but unpaid losses	\$164,000	\$215,973	\$(51,973)
Less: Reinsurance recoverable on unpaid losses	<u>149,000</u>	<u>196,704</u>	<u>(47,704)</u>
Net Unpaid Losses	<u>\$ 15,000</u>	<u>\$ 19,269</u>	<u>\$ (4,269)</u>

The above difference of \$4,269 was not considered material for purposes of this examination; therefore, no adjustment was made to surplus.

The examiners' review of claim files included open claims, paid claims, claims closed without payment, and all claims which were denied during the examination period. The review indicated that claims are investigated and evaluated properly and that payments are made promptly and in accordance with policy provisions upon the submission of a proper proof of loss. In addition, the review of claims handling procedures and files revealed the following:

1. A proper loss register is maintained.
2. Claim files contained sufficient investigatory data and documentation to verify settlement payments or reserve estimates.
3. Proofs of loss were properly signed.

### Unpaid Loss Adjustment Expenses

**\$600**

This liability represents the company's estimate of amounts necessary to settle losses which were incurred prior to December 31, 2004, but which remained unpaid as of year-end. The methodology used by the company in establishing this liability is estimation based on prior year adequacy and open losses.

The examiners' analysis of expenses incurred in the current year related to the settlement of prior year losses, as well as estimates of amounts necessary to settle any prior losses remaining unpaid at the examination date, determined this liability to be adequately stated.

**Commissions Payable** **\$11,220**

This liability represents the commissions payable to agents as of December 31, 2004. The company collects premiums directly from the insured and then remits the commissions to the agents. Subsequent cash disbursements verified the above balance.

**Unearned Premiums** **\$279,600**

This liability represents the reserve established for unearned premiums in compliance with s. Ins 13.08 (3), Wis. Adm. Code. This reserve was established as follows:

The company takes an inventory of premiums in force and deferred installments at year-end. The company then calculates the unearned premium using the pro rata method to derive the year-end balance. Direct unearned premium is reduced for the unearned premium held by the company's reinsurer under the Class B first surplus and quota share treaties and the ceded portion of the deferred installments.

The examiners' review verified the validity of this liability.

**Reinsurance Payable** **\$22,218**

This liability consists of amounts due to the company's reinsurer at December 31, 2004, relating to transactions which occurred on or prior to that date.

Class A – Liability	\$ 9,072
Class C-1 – First Excess of Loss	1,200
Class C-2 – Second Excess of Loss	700
Class D/E – Stop Loss	(5,600)
Deferred Reinsurance Payable	<u>16,846</u>
Total	<u>\$22,218</u>

Subsequent cash disbursements and reinsurance accountings verified the amount of this liability.

**Amounts Withheld for the Account of Others** **\$1,684**

This liability represents employee payroll deductions in the possession of the company at December 31, 2004. Supporting records and subsequent cash disbursements verified this item.



**Accounts Payable****\$169**

This liability consists of amounts due to creditors for miscellaneous expenses at December 31, 2004. Supporting records and subsequent cash disbursements verified this item.

**Premiums Received in Advance****\$19,089**

This liability represents the total premiums received prior to year-end for policies with effective dates after December 31, 2004. The examiners reviewed 2004 premium and cash receipt records to verify the accuracy of this liability.

## **V. CONCLUSION**

During the examination of Merrimac Mutual Insurance Company, it was determined that the company had complied with three, and partially complied with one of the four prior examination recommendations. One recommendation and two suggestions were made as a result of this current examination. The recommendation and suggestions are listed in summary form on the following page. There were no reclassifications or adjustments to surplus.

Merrimac Mutual Insurance Company reported admitted assets of \$3,063,628, liabilities of \$349,580, and surplus of \$2,741,048 at December 31, 2004. The company has generated positive net income each year, increased admitted assets 23.9%, and increased surplus 25.6% since the prior exam. The company has had steady growth in both the gross and net premiums written and the number of policies in force. With the exception of 2004, a year in which the company faced two significant losses, the company has kept its underwriting ratio at or under the average for the Wisconsin town mutual industry as a whole.

## VI. SUMMARY OF COMMENTS AND RECOMMENDATIONS

1. Page 14 - Underwriting—It is suggested that the company periodically review and update its underwriting guide, including maintenance of current rates and require photographs of all insured risks in order to have better supporting documentation of the condition of the risks.
2. Page 15 - Accounts and Records—It is recommended that the company comply with s. Ins 13.05 (4) (d), Wis. Adm. Code, by transferring its bank reconciliation function to a person other than the Treasurer.
3. Page 16 Business Continuity Plan—It is suggested that the company expand its business continuity plan to address all types of disasters and develop an office procedure manual for the cross-training of employees.

## **VII. ACKNOWLEDGMENT**

The courteous cooperation extended to the examiners by the company's personnel is hereby acknowledged.

In addition to the undersigned, Carina Toselli of the Office of the Commissioner of Insurance, State of Wisconsin, participated in the examination.

Respectfully submitted,

Russell Lamb  
Examiner-in-Charge